



# Beyond the expense ratio

## The total cost of owning ETFs

As expense ratios of exchange-traded funds (ETFs) trend downward across the industry, more investors appear to be turning to ETFs instead of actively managed mutual funds. While a lower expense ratio is certainly attractive, the true cost of owning ETFs can vary across providers and is more complex than many realize. By understanding all the factors affecting cost, investors are better equipped to make sound investment decisions.

# Costs matter

The cost of investing is not always straightforward and transparent across the entire industry. To fully understand the ETF landscape, investors should be aware of both the explicit and the implicit costs.



## Explicit costs explained

Explicit costs are clear, set costs that an investor sees in advance and pays directly, either up front or on an ongoing basis.

### Operating expense ratio

The annual fee paid by shareholders to cover the expenses associated with managing and running the fund. This fee is stated on an annual basis and is deducted from the total assets of the fund, subsequently reducing the return of the fund to its investors over time.

### Commission

A fee paid to a broker or advisor to facilitate the buying or selling of an ETF. In today's market environment, some brokerage platforms offer a select list of ETFs that trade commission-free, subject to certain restrictions.

## Implicit costs explained

Implicit costs are costs that an investor cannot directly control or impact and that may vary based on market circumstances.

### Bid/ask spread

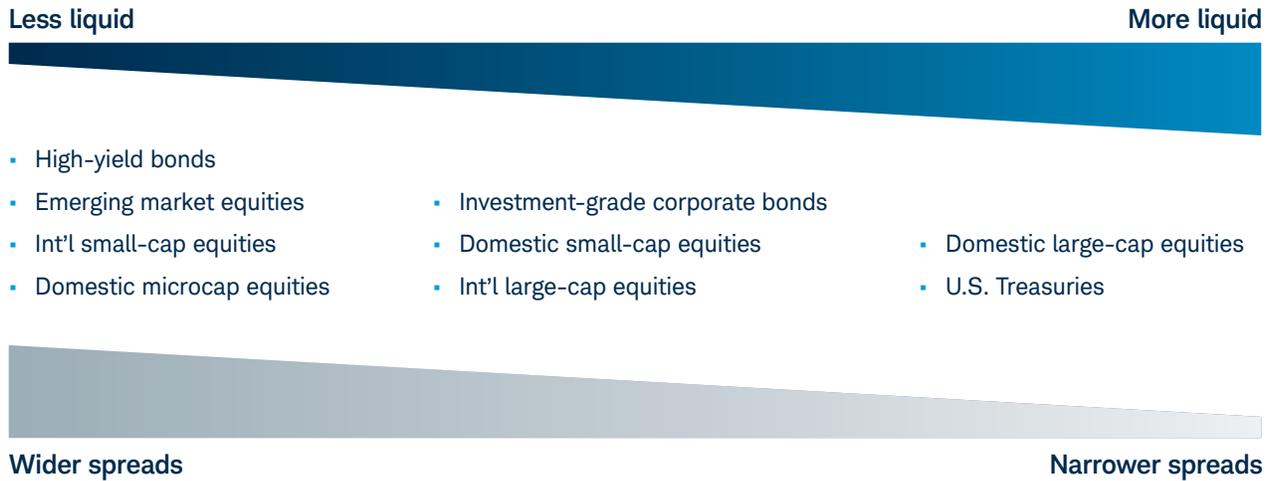
Just like a stock, an ETF's spread is the difference between the price at which someone is willing to buy the security—the "bid"—and the price at which someone is willing to sell the security—the "ask," or "offer." The spread on an ETF is driven by many factors including, but not limited to, supply and demand for the underlying securities, supply and demand for shares of the ETF itself, and the historical and current magnitude of price fluctuation of the ETF's underlying asset class.

Broadly speaking, ETFs holding assets that are difficult to value in real time or that may be thinly traded will tend to have wider bid/ask spreads and be associated with higher trading costs than ETFs holding more liquid assets, such as large-cap U.S. stocks.

### Tracking difference

Tracking difference is the delta between the ETF's net asset value performance and the performance of its underlying index. In a vacuum, an index ETF would have a return equal to its benchmark, minus fees. However, in the real world, many other factors—including the degree to which an ETF uses a sampling technique, timing of trades, cash drag, and rebalancing costs—can chip away at some ETFs' performance and contribute to tracking difference. Low tracking difference may reflect the strategy or portfolio management approach.

The impact of each cost depends on the investor's goals. For example, if the investor is planning to hold an ETF for less than a year, the bid/ask spread may be more important than the operating expense ratio.

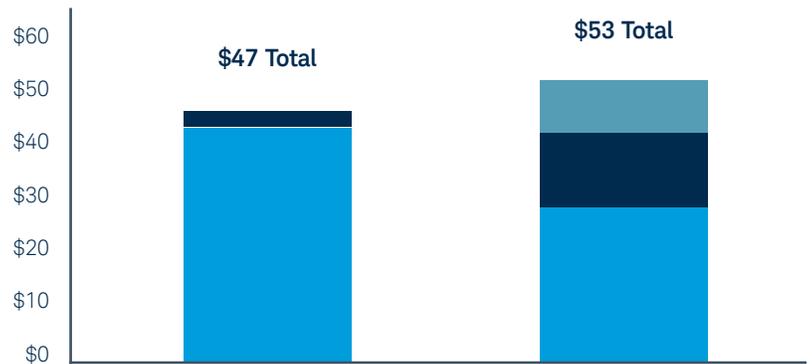


# Calculating the cost of owning an ETF

## Cost of a \$10,000 investment

Although ETF A has a higher expense ratio than ETF B, it has a lower total cost of ownership because it charges no commissions and has a lower bid/ask spread.

This example assumes each ETF is bought and sold once, so the owner has effectively paid the bid/ask spread by first buying at the “ask” price and then selling at the “bid” price. The commissions paid reflect both the purchase and the subsequent sale of the ETF.



	ETF A		ETF B	
	Percentage	Amount	Percentage	Amount
Expense ratio	0.44%	\$44	0.29%	\$29
Bid/ask spread	0.03%	\$3	0.14%	\$14
Trading commissions	0.00%	\$0	0.10%	\$10
<b>Total cost after one year</b>	<b>0.47%</b>	<b>\$47</b>	<b>0.53%</b>	<b>\$53</b>

For illustrative purposes only. The examples above do not represent investment in any particular ETF. Source: Schwab Center for Financial Research™

# Summary

It is important to help investors evaluate ETF costs based on their specific situation and objectives. The more frequently an investor trades, the more important it is to pay attention to commissions and bid/ask spreads. However, for investors who plan to hold for the long haul, the fees, liquidity, and tracking difference of the ETF can have a more profound impact on investment returns over time.



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**Investment returns will fluctuate and are subject to market volatility, so that an investor's shares, when redeemed or sold, may be worth more or less than their original cost. Unlike mutual funds, shares of ETFs are not individually redeemable directly with the ETF. Shares of ETFs are bought and sold at market price, which may be higher or lower than the net asset value (NAV).**

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